

Message Text

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INFO AMCONSUL QUEBEC

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E. O. 11652: N/A
TAGS: EFIN, CA
SUBJ: QUEBEC FINANCIAL ACTIVITIES

REF: MONTREAL 1204

BEGIN SUMMARY: RELYING ON OVERSEAS CAPITAL MARKETS, HYDRO QUEBEC HAS NOW MET NEARLY THREE-QUARTERS OF ITS FINANCING REQUIREMENTS FOR CURRENT YEAR. SIGNING FOR APPROXIMATELY \$200 MILLION PRIVATE PLACEMENT IN US EXPECTED TO TAKE PLACE IN SEPTEMBER. WHILE RECEPTION IN EUROPE HAS BEEN GOOD, HYDRO QUEBEC MUST STILL PROVE ITSELF IN US MARKET, WHICH IS ONLY MARKET LARGE ENOUGH TO MEET HYDRO'S HEAVY CAPITAL REQUIREMENTS OVER COMING YEARS. US INVESTORS ARE NOT HAPPY ABOUT QUEBEC SITUATION, BUT APPEAR WILLING GO ALONG WITH HYDRO-QUEBEC AS LONG AS PROVINCE DOES NOTHING TO JEOPARDIZE ITS FINANCIAL INTEGRITY. IT IS ALSO EVIDENT THAT HYDRO-QUEBEC IS GOING TO HAVE TO WORK MUCH HARDER TO RAISE MONEY IN US THAN WAS CASE IN PAST.

2. PROVINCE OF QUEBEC HAS NOW RAISED \$465 MILLION OF ESTIMATED
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FINANCIAL REQUIREMENTS FOR YEAR OF \$1-1.3 BILLION. FINANCE MINISTER PARIZEAU WOULD LIKE TO HOLD LINE AT \$1 BILLION, BUT WILL COME UNDER INTENSE PRESSURE TO APPROVE SUPPLEMENTARY BUDGET TO RELIEVE UNEMPLOYMENT, WHICH STOOD AT 10.3 O/O IN JULY FOR QUEBEC. IF LINE IS HELD, FINANCING REQUIREMENTS CAN BE MET BY PLACEMENT WITH CAISSE FOR EARMARKED \$300 MILLION AND ADDITIONAL PLACEMENT IN EITHER CANADA OR OVERSEAS. SUPPLEMENTAL

BUDGET WOULD PROBABLY REQUIRE FURTHER FINANCING FROM CAISSE, WHICH COULD LEAD TO CONFRONTATION OVER ROLE OF CAISSE IN QUEBEC'S ECONOMIC DEVELOPMENT. END SUMMARY.

3. SINCE REFTEL, HYDRO QUEBEC HAS COMPLETED PLACEMENTS IN GERMANY, JAPAN AND SWITZERLAND. GERMAN ISSUE WAS WELL-RECEIVED, WITH TOTAL BEING INCREASED FROM \$150 MILLION DEUTSCHE MARK TO \$200 MILLION DEUTSCHE MARK (\$93 MILLION) AND INTEREST RATE REDUCED FROM ORIGINALLY PLANNED 6.75 O/O TO 6.50 O/O IN FACE OF STRONG INITIAL DEMAND. ACCORDING TO HYDRO FINANCIAL MANAGER, ORDERS FOR ISSUE EXCEEDED \$600 MILLION DEUTSCHE MARK. MATURITY WAS SET AT 10 YEARS, WITH ISSUE OFFERED AT 100.5. JAPANESE FINANCING WAS IN FORM OF \$20 BILLION YEN LOAN (\$74 MILLION). TERMS WERE 12-YEAR MATURITY, WITH INTEREST RATE SET AT 8.6 O/O. LOAN WAS LARGEST YEN DENOMINATED LOAN EVER MADE OVERSEAS BY JAPANESE BANKS. SWISS ISSUE WAS PRIVATE-PLACEMENT FOR \$300 MILLION SWISS FRANCS (\$130 MILLION). TERMS WERE FIVE-YEAR MATURITY WITH 5.25 O/O INTEREST. PROCEEDS OF ALL THREE ISSUES HAVE BEEN CONVERTED INTO US DOLLARS, BUT IN VIEW OF RECENT WEAKNESS IN CANADIAN DOLLAR, HAVE NOT YET BEEN CONVERTED INTO CANADIAN DOLLARS.

4. DISCUSSIONS ON US PRIVATE-PLACEMENT REPORTED REFTEL CONTINUE, WITH HYDRO OFFICIALS STILL EXPECTING FINAL AMOUNT TO TOTAL \$200-225 MILLION. PRUDENTIAL INSURANCE HAS REPORTEDLY OBTAINED COMMITTEE APPROVAL TO PARTICIPATE IN ISSUE, AND OTHER BUYERS LIMITED OFFICIAL USE

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NOW TAKING PROJECT TO FINANCIAL COMMITTEES FOR FINAL APPROVAL. CLOSING EXPECTED TO OCCUR IN LATE SEPTEMBER. TERMS REMAIN AS EARLIER REPORTED. WHILE ISSUE WILL GO THROUGH, THERE IS NO DOUBT THAT HYDRO-QUEBEC, IN SPITE OF ITS SOUND FINANCIAL RECORD, IS FINDING US MARKET LESS RECEPTIVE THAN IT WAS BEFORE NOVEMBER ELECTION. CONVERSATIONS WITH BIG INVESTORS IN US INDICATE THAT THEY ARE FOLLOWING QUEBEC SITUATION CLOSELY AND ARE VERY CONCERNED ABOUT POSSIBLE ECONOMIC EFFECTS OF POLITICAL SITUATION.

5. WALL STREET JOURNAL ARTICLE RECENTLY QUOTED COMMENTS OF TORONTO ANALYST WHO SAID IT WAS NEGATIVE REFLECTION ON CREDIT STANDING OF HYDRO-QUEBEC TO DO SMALL DEALS IN A NUMBER OF MARKETS AND PARTICULARLY TO MAKE EXCESSIVE USE OF OVERSEAS MARKETS. THERE IS SOME TRUTH IN THESE COMMENTS, BUT UNDER CIRCUMSTANCES HYDRO-QUEBEC PROBABLY HAD NO ALTERNATIVE. FOR HYDRO VIEWPOINT, GENERAL MANAGER OF FINANCE FOR HYDRO-QUEBEC REPLIED THAT MARKETS HAD NOT BEEN AS FAVORABLE AS THEY NOW WERE FOR SOME TIME, AS LONGER TERM MATURITIES WERE NOW AVAILABLE IN OVERSEAS MARKETS, AND THAT "SMALL DEALS" REFERRED TO INCLUDED LARGEST TRANSACTIONS ENTERED INTO BY JAPANESE FOR OVERSEAS LOANS AND LARGEST LONG TERM LOAN EVER PLACED IN EURO-DOLLAR MARKET. MOREOVER, EVEN WITHOUT TAKING INTO CONSIDERATION

EFFECTS OF ELECTION OF PQ LAST NOVEMBER, PRUDENCE WOULD HAVE REQUIRED DEEMPHASIZING US MARKET FOLLOWING \$1.3 BILLION US FINANCING LAST YEAR. HYDRO FINANCIAL MANAGERS READILY ADMIT THEIR INTEREST IN FLYING THE FLAG TO KEEP HYDRO'S NAME IN PUBLIC EYE, BUT STATE THAT RECENT FLURRY OF ACTIVITY, CONCENTRATING FINANCIAL OPERATIONS IN TWO MONTH PERIOD, IS DUE TO SPECIAL CIRCUMSTANCES. ANTICIPATING FAVORABLE REACTION, HYDRO QUEBEC MADE DECISION EARLY IN YEAR (MONTREAL 381) TO DELAY FINANCIAL OPERATIONS UNTIL HYDRO FINANCIAL REPORT WAS PUBLISHED, UNTIL RATING AGENCIES HAD COMPLETED REVIEWS OF HYDRO-QUEBEC, AND UNTIL SPECIAL STUDIES BEING PREPARED BY INVESTMENT FIRMS SUCH AS KIDDER PEABODY WERE RELEASED. UPON COMPLETION OF FOREGOING ACTIVITIES, FINANCIAL NEGOTIATIONS BEGAN IMMEDIATELY.

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6. HYDRO'S FINANCING REQUIREMENTS FOR YEAR WERE EARLIER ESTIMATED AT \$1 BILLION. HYDRO HAS NOW COMPLETED FINANCING TOTALING \$718 MILLION. PENDING PRIVATE PLACEMENT IN US WILL BRING TOTAL UP TO AT LEAST \$918 MILLION. HYDRO NOW HAS PLANS FOR ADDITIONAL ISSUES OF \$100 MILLION ON THE CANADIAN MARKET, \$200 MILLION ON US PUBLIC MARKET, AND \$35 MILLION ON SWISS

PUBLIC MARKET, BRINGING TOTAL FINANCING FOR YEAR TO \$1,253 MILLION. WHILE TOTAL IS ABOVE EARLIER PROJECTIONS, HYDRO WOULD LIKE TO END YEAR WITH COMFORTABLE CASH BALANCE, AS FINANCIAL REQUIREMENTS FOR JAMES BAY PROJECT ARE AT PEAK NEXT YEAR.

7. FINANCING BY PROVINCE OF QUEBEC FOR CURRENT FISCAL YEAR INCLUDES \$150 MILLION DEUTSCHE MARK (\$65 MILLION) PUBLIC ISSUE, WITH TEN YEAR MATURITY CARRYING 7.25 O/O COUPON; \$300 MILLION SEVEN YEAR EURODOLLAR LOAN, WITH INTEREST RATE FLUCTUATING FROM 1 1/2 TO 1 1/4 O/O ABOVE LONDON INTERBANK RATE (LIBOR); AND \$100 MILLION PLACEMENT WITH QUEBEC'S CAISSE DE DEPOT. (TERMS FOR LAST ISSUE ARE NOT AVAILABLE). TOTAL FOR YEAR IS THUS \$465, AS COMPARED TO PROJECTIONS OF TOTAL FINANCIAL NEEDS OF \$900 MILLION CONTAINED IN QUEBEC BUDGET. OTHER SOURCES, HOWEVER, HAVE PLACED FINANCIAL REQUIREMENTS AT LEVELS RANGING FROM \$1-1.3 BILLION, AND LIMITED OFFICIAL USE

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OPINION IN FINANCIAL COMMUNITY IN MONTREAL IS DIVIDED AS TO WHETHER GOVERNMENT WILL BE ABLE TO HOLD TO EARLIER PROJECTIONS.

8. ISSUE HAS BEEN CLOUDED BY STATEMENT OF MINISTER OF COMMERCE AND INDUSTRY, RODRIGUE TREMBLAY, APPARENTLY CALLING FOR SUPPLEMENTARY BUDGET TO RELIEVE UNEMPLOYMENT, WITH JULY FIGURES PLACING UNEMPLOYMENT RATE IN QUEBEC AT 10.3 O/O. MINISTER OF STATE FOR ECONOMIC DEVELOPMENT BERNARD LANDRY SUBSEQUENTLY STATED, HOWEVER, THAT GOVERNMENT HAS NO INTENTION OF PRESENTING SUPPLEMENTARY BUDGET TO RELIEVE UNEMPLOYMENT. SOURCES IN ACADEMIC COMMUNITY WHO WORK CLOSELY WITH QUEBEC GOVERNMENT EXPECT FINANCE MINISTER PARIZEAU TO ATTEMPT TO HOLD LINE WITH TOTAL FINANCING REQUIREMENTS BEING HELD AT APPROXIMATELY \$1 BILLION LEVEL. SOURCES IN BANKING COMMUNITY BELIEVE THAT FINANCING REQUIREMENTS WILL BE HIGHER, PROBABLY FROM \$1.2 - 1.3 BILLION, WITH A SUPPLEMENTARY BUDGET BEING NECESSARY, PERHAPS IN LATE JANUARY.

9. SHOULD HIGHER FIGURE PROVE TO BE ACCURATE, PROVINCIAL GOVERNMENT WOULD PROBABLY HAVE TO LEAN HEAVILY ON CAISSE DE DEPOT, WHICH HAS EARMARKED \$400 MILLION FOR PROVINCIAL GOVERNMENT DURING CURRENT FISCAL YEAR. IF FINANCIAL NEEDS ON OTHER HAND HELD TO \$1 BILLION, REMAINING REQUIREMENTS COULD PROBABLY BE MET BY USE OF REMAINING \$300 MILLION TOTAL IN CAISSE AND BY \$200 MILLION FINANCING OPERATION ON CANADIAN OR EUROPEAN MARKETS. PROVINCIAL GOVERNMENT HAS ISSUED SAVINGS BONDS IN PAST (\$316.5 MILLION IN 1976) BUT IS SAID TO BELIEVE MARKET IS NOW SATURATED AND WOULD PREFER TO FINANCE THROUGH OTHER MEANS THIS YEAR. HEAVY USE OF CAISSE COULD LEAD TO CONFRONTATION, AS CAISSE HAS PRIDED ITSELF TO SOME EXTENT ON INDEPENDENT STANCE, WITH PRIORITY GIVEN TO PROTECTION OF CAPITAL. PARIZEAU, HOWEVER, HAS LONG LOOKED ON CAISSE AS VEHICLE WHOSE INVESTMENT POLICIES SHOULD BE MORE CLOSELY INTEGRATED WITH GOVERNMENT PRIORITIES FOR ECONOMIC

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DEVELOPMENT. GIVEN FREQUENT TRIPS THIS YEAR BY HYDRO-QUEBEC AND PROVINCE TO OVERSEAS FINANCIAL MARKETS, PROVINCE WOULD PROBABLY BE HARD-PRESSED TO MEET ANY SUPPLEMENTAL FINANCIAL REQUIREMENTS THIS YEAR WITHOUT RECOURSE TO CAISSE. UNDER SUCH CIRCUMSTANCES, PARIZEAU WOULD BE LIKELY TO HAVE HIS WAY. ALONG SAME LINES, IT IS SIGNIFICANT THAT PROVINCIAL GOVERNMENT HAS UNDERTAKEN STUDY, HEADED BY LANDRY, TO INVESTIGATE MEANS OF IMPROVING CHANNELING AND USE OF QUEBEC'S SAVINGS, WITH AIM OF PROMOTING ECONOMIC DEVELOPMENT.

10. COMMENT: IN VIEW OF RECNET UNEMPLOYMENT FIGURES, THERE IS GOOD CHANCE THAT FINANCE MINISTER PARIZEAU WILL BE FORCED TO GO ALONG WITH SUPPLEMENTARY BUDGET. WHILE HE IS KNOWN TO HAVE STRONG COMMITMENT TO HOLDING THE LINE, HE IS ALREADY SEEN BY MANY IN PQ AS TOO INFLEXIBLE. ANY RETREAT FROM HIS "BANKERS BUDGET" FACES PARIZEAU WITH ANOTHER PROBLEM, HOWEVER, IN FORM OF DISAPPROVAL ON PART OF FINANCIAL COMMUNITY, WHOSE SUPPORT QUEBEC MUST MAINTAIN IF IT IS TO ACHIEVE ITS ECONOMIC OBJECTIVES.

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11. FINANCIAL PICTURE AT THIS POINT IS MIXED. HYDRO-QUEBEC

HAS DONE WELL IN OVERSEAS MARKETS, BUT TO SOME EXTENT THAT'S STILL THE BUSH LEAGUE, AND HYDRO MUST MAINTAIN HIGH CREDIT STANDING IN US TO ENABLE IT TO FINANCE ESTIMATED CAPITAL EXPENDITURES OF \$12 BILLION OVER NEXT THREE YEARS. GIVEN MAGNITUDE OF NEEDS, OVERSEAS CAPITAL MARKETS ARE FAR FROM ADEQUATE. WHILE US INVESTORS ARE NOT HAPPY ABOUT QUEBEC SITUATION, THEY APPEAR WILLING TO GO ALONG WITH HYDRO-QUEBEC AT PRESENT. THEY HAVE WARNED INVESTMENT BANKERS, HOWEVER, THAT ANY MOVES BY PROVINCE THAT COULD BE INTERPRETED AS COMPROMISING HYDRO'S FINANCIAL INTEGRITY WILL RESULT IN TURNING OFF FLOW OF FUNDS FROM US. AND, OVER LONGER TERM, INVESTORS ARE CONCERNED ABOUT IMPACT ON ECONOMIC STRENGTH OF PROVINCE BY SUCH MEASURES AS BILL 101 (LANGUAGE LEGISLATION). LIKE IT OR NOT, PREMIER LEVESQUE WILL HAVE TO LIVE WITH FACT THAT IT'S NOT ONLY OTTAWA, BUT ALSO US INVESTORS, WHO CONTROL MANY OF THE LEVERS THAT DETERMINE COURSE OF QUEBEC'S ECONOMY.

FINANCIAL SUMMARY (\$ MILLION)

HYDRO

QUEBEC PROVINCE

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FINANCED TO DATE (1)	718	465
PENDING SETTLEMENT	200 (US)	N/A
PROPOSED	335	N/A
TOTAL	1,253	465
ESTIMATED REQUIREMENTS	1,000	1-1,300

(1) HYDRO QUEBEC FISCAL YEAR BEGINS JAN. 1. PROVINCE FISCAL YEAR BEGINS APRIL 1.

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